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No. 07-512

IN THE
Supreme Court of the United States

PACIFIC BELL TELEPHONE COMPANY
D/B/A AT&T CALIFORNIA, ET AL.,
Petitioners,

v.

LINKLINE COMMUNICATIONS, INC., ET AL.,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether a plaintiff states a claim under Section 2 of the Sherman Act by alleging that the defendant – a vertically integrated retail competitor with an alleged monopoly at the wholesale level but no antitrust duty to provide the wholesale input to competitors – engaged in a "price squeeze" by leaving insufficient margin between wholesale and retail prices to allow the plaintiff to compete.

LIST OF PARTIES TO THE PROCEEDINGS

Petitioners Pacific Bell Telephone Company (which now does business as AT&T California (formerly SBC California)), Pacific Bell Internet Services (now known as SBC Internet Services, Inc. d/b/a AT&T Internet Services and AT&T Entertainment Services), and SBC Advanced Solutions, Inc. (d/b/a AT&T Advanced Solutions) were the defendants in the district court proceedings and the appellants in the court of appeals proceedings.

Respondents linkLine Communications, Inc., In-Reach Internet LLC (now known as InReach Internet, Inc.), Om Networks d/b/a Omsoft Technologies, and Nitelog, Inc. d/b/a Red Shift Internet Services were the plaintiffs in the district court proceedings and the appellees in the court of appeals proceedings.

CORPORATE DISCLOSURE STATEMENTS

Pursuant to Rule 29.6 of the Rules of this Court, petitioners Pacific Bell Telephone Company (which now does business as AT&T California (formerly SBC California)), Pacific Bell Internet Services (now known as SBC Internet Services, Inc. d/b/a AT&T Internet Services and AT&T Entertainment Services), and SBC Advanced Solutions, Inc. (d/b/a AT&T Advanced Solutions) state the following:

Pacific Bell Telephone Company is a wholly owned subsidiary of AT&T Teleholdings, Inc., which is a wholly owned subsidiary of AT&T Inc. (formerly SBC Communications Inc.). AT&T Inc. has no corporate parent. No publicly held corporation owns 10% or more of the stock of AT&T Inc. AT&T California (formerly SBC California) is the trade name under which Pacific Bell Telephone Company does business in California.

SBC Internet Services, Inc. (formerly Pacific Bell Internet Services) is wholly owned by AT&T Teleholdings, Inc., which is wholly owned by AT&T Inc. SBC Internet Services, Inc. does business under the trade names AT&T Internet Services and AT&T Entertainment Services.

SBC Advanced Solutions, Inc. is jointly owned by AT&T Inc. and AT&T Teleholdings, Inc. SBC Advanced Solutions, Inc. does business under the trade name AT&T Advanced Solutions.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-24a) is reported at 503 F.3d 876. The orders of the district court (Pet. App. 25a-57a, 58a-91a) are not reported.

JURISDICTION

The court of appeals entered its judgment on September 11, 2007. The petition for a writ of certiorari was filed on October 17, 2007, and was granted on June 23, 2008 (128 S. Ct. 2957). The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 2 of the Sherman Act, 15 U.S.C. § 2, provides:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

STATEMENT OF THE CASE

Respondents (plaintiffs below) purchase communications services at wholesale from petitioners (collectively, "AT&T") and use them to provide retail Internet-access service in competition with AT&T. Respondents alleged that AT&T was a monopolist at the wholesale level and had violated Section 2 of the Sherman Act by creating a "price squeeze." Specifically, respondents alleged that AT&T left an "artificially low" margin between the wholesale price AT&T charged respondents for communications services and the retail prices AT&T charged for Internet-access service, placing respondents at an "unfair disadvantage." Compl. ¶ 19 (JA17).

The Ninth Circuit acknowledged that, under this Court's decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), AT&T had no antitrust duty to offer the wholesale input to competitors. Nevertheless, the court found that, because "price squeeze theory form[s] part of the fabric of traditional antitrust law," Pet. App. 14a, respondents had stated a claim.

The Ninth Circuit's decision misreads *Trinko*, which holds that a monopolist has no Section 2 duty to cooperate with a rival in the absence of an affirmative duty to deal under the antitrust laws. That holding necessarily extends to the price at which a monopolist makes a wholesale input available to its competitors. Moreover, the price-squeeze theory approved by the Ninth Circuit – which has no support in this Court's decisions – penalizes pro-competitive conduct and threatens liability in the absence of consumer harm. The decision is thus inconsistent with the most basic canon of this Court's antitrust jurisprudence: that the Sherman Act protects *competition*, not *competitors*. The Court should reverse.

A. Regulatory Background

Under Federal Communications Commission ("FCC") regulations adopted in the 1980s, a Bell Operating Company ("BOC") that wanted to provide computer-related services over its telephone network was required also to provide any underlying communications services to unaffiliated competitors on a nondiscriminatory, common-carrier basis.[1] The FCC indicated that this obligation applied to Internet-access services in general and, in particular, to high-speed Internet-access service provided over digital subscriber lines ("DSL").[2] (In *Brand X*, this Court upheld an FCC determination that cable companies – which provide high-speed Internet-access service over cable lines in competition with telephone companies' DSL service – are not subject to analogous obligations to provide the underlying transmission capacity to unaffiliated Internet-access providers. *See* 545 U.S. at 975, 986-1003.)

In the late 1990s, AT&T's BOC affiliate, petitioner Pacific Bell Telephone Company ("Pacific Bell"), began offering retail high-speed Internet-access service, using DSL technology. Pacific Bell also introduced – as it was required to do – tariffed offerings for "DSL Transport," the wholesale "underlying communications service" that is one component of DSL-based

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[1] *See generally National Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 975-77, 992-95 (2005); Report and Order, *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 104 F.C.C.2d 958, 964, ¶ 4 (1986). *See also* Pet. App. 78a-84a (describing history of FCC regulations in this area.

[2] *See* Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 17 FCC Rcd 3019, 3031, ¶ 22 (2002).

Internet-access service. *See* Pet. App. 84a. Unaffiliated Internet Service Providers ("ISPs") could purchase DSL Transport from Pacific Bell and then combine it with other facilities and services to provide Internet-access service to retail customers in competition with Pacific Bell and others. *See id.* at 60a.

Subsequently, AT&T modified the structure of its subsidiaries so that defendant SBC Advanced Solutions, Inc. ("SBC-ASI") provided DSL Transport to defendant Pacific Bell Internet Services ("PBIS") and to unaffiliated ISPs. PBIS (rather than Pacific Bell) provided Internet-access service to retail customers. The FCC required SBC-ASI, under this new structure, to provide DSL Transport to unaffiliated ISPs on the same terms and conditions as it provided the service to affiliates.[3] Hence, throughout the period covered by the complaint, AT&T's affiliates' offering of DSL Transport to unaffiliated ISPs has been compelled by and pursuant to FCC regulations.[4]

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[3] *See* Memorandum Opinion and Order, *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 17 FCC Rcd 27000, 27006-07, ¶ 11, 27009, ¶ 15 (2002).

[4] The FCC has eliminated the obligation of many local telephone companies to provide DSL Transport as a condition of provision of DSL-based Internet-access service. *See* Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853 (2005), *petitions for review denied*, *Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007). In so doing, the FCC noted that "[t]here are numerous technologies and network designs that form, or potentially could form, part of the broadband telecommunications infrastructure of the 21st century," including cable modem service, which accounted for more than 60 percent of residential high-speed Internet connections at the end of 2004. *Id.* at 14873, ¶ 33; *see id.* at 14881-82,

In addition, because DSL Transport is offered as a common-carrier communications service, it is subject to regulation under Title II of the Communications Act of 1934, 47 U.S.C. § 201 *et seq*. The Act requires that "[a]ll charges, practices, classifications, and regulations for and in connection with [interstate] communication service, shall be just and reasonable." *Id*. § 201(b). The Act also forbids "any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service." *Id*. § 202(a).

B. District Court Proceedings

1. Respondents are ISPs that "provide[] access to the Internet and related services." Compl. ¶¶ 3-6 (JA11-12). In July 2003, they filed a complaint against petitioners Pacific Bell, PBIS, and SBC-ASI, accusing them of "monopoliz[ing] and attempt[ing] to monopolize . . . the relevant markets for providing DSL and other Internet services and local telecommunication services" in areas of California where AT&T is authorized to provide local service. *Id*. ¶ 22 (JA18). Respondents alleged that, "to exclude and unreasonably impede competition from independent

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¶ 51; *see also Brand X*, 545 U.S. at 1001 (quoting FCC finding that "'[r]esidential high-speed access to the Internet is evolving over multiple electronic platforms, including wireline, cable, terrestrial wireless and satellite'").

As a condition of its recent merger with BellSouth, however, AT&T remains under an obligation to continue to provide the service, at a price no higher than the retail rate AT&T charges for retail DSL-based Internet-access service. *See* Memorandum Opinion and Order, *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, 22 FCC Rcd 5662, 5814-15, App. F (2007), *on partial reconsideration on other grounds*, 22 FCC Rcd 6285 (2007).

ISPs," petitioners had "created a price squeeze by charging ISP[s] a high wholesale price in relation to the price at which defendants were providing retail services." *Id.* ¶ 23(a) (JA18). In addition, respondents alleged that petitioners "adopted procedures carefully calculated to deny ISPs access to an essential facility and to preserve and maintain its monopoly control of DSL access to the Internet." *Id.* ¶ 23 (JA19). The complaint makes no mention of competing high-speed Internet-access platforms such as cable modem and wireless technologies.

After this Court decided *Trinko*, AT&T moved for judgment on the pleadings, *see* Fed. R. Civ. P. 12(c), asserting that AT&T had provided DSL Transport to rival providers of retail Internet-access service only under FCC compulsion; that AT&T had no *antitrust* duty to deal with respondents at all; and that respondents' complaints about the terms of dealing between petitioners and respondents therefore failed to state a claim under Section 2. *Cf. Trinko*, 540 U.S. at 409-10.

2. The district court agreed that the bulk of respondents' allegations failed to state a claim and could not proceed. *See* Pet. App. 77a-86a. The court, however, refused to dismiss the price-squeeze claim. The court stated that *Trinko* "simply does not involve price-squeeze claims" and rejected the argument that "a price-squeeze claim essentially boils down to a claim that Firm One is refusing to deal with Firm Two on Firm Two's price terms." *Id.* at 86a. The court found that price-squeeze claims arise in narrower circumstances than other refusal-to-deal claims, because they are limited to circumstances where a firm "operates both as a retailer and a wholesaler whose customers are also its competitors." *Id.* at 87a

(internal quotation marks omitted). The court also stated that, "to the extent that price-squeeze claims are subject to the requirements set forth in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), then the transmutability of refusal-to-deal claims is limited still more." *Id.*

The district court also found that the Ninth Circuit in *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992), had already "rejected the argument that the existence of a regulatory structure precludes antitrust liability under a price squeeze theory." Pet. App. 88a. In addition, the court noted that, "while the *Trinko* Court justified its decision not to expand the scope of Section 2 liability by reference to the existence of a regulatory structure designed to deter and remedy anticompetitive conduct, it justified its conclusion that Trinko's allegations failed to state a claim under existing antitrust standards by reference to existing case law." *Id.* at 90a. "And here, unlike the plaintiff's refusal-to-deal claim in *Trinko*, Plaintiffs' price-squeezing claim falls within the range of recognized Section 2 claims." *Id.*

3. As ordered by the district court, respondents amended their complaint to elaborate their price-squeeze claim. The amended complaint alleges that "defendants unlawfully manipulated their dual role" as a "wholesale-monopoly supplier and retail competitor" by "intentionally charging independent ISPs wholesale prices that were too high in relation to prices at which defendants were providing retail DSL services . . . thereby making it impossible for independent ISP competitors . . . to compete at the low retail prices set by defendants." Am. Compl. ¶ 25(A)(1) (JA35).

The amended complaint further alleges that "for a period" AT&T had "charg[ed] wholesale DSL [Transport] prices . . . that actually exceeded the prices at which [AT&T] . . . was charging retail end-user customers." *Id.* Respondents alleged that, if they charged the same price for Internet-access service as AT&T, they "could not cover the cost of providing" that retail service and that, if AT&T "charged [its] retail affiliates the same wholesale costs for DSL transport that [it] charged [its] wholesale . . . customers . . . , defendants could not cover their wholesale costs and make a profit." *Id.* ¶ 25(A)(2)-(3) (JA35-36). The amended complaint charges that "defendants are clearly attempting to compensate for deliberately sacrificing profits on the retail end of their operations (with offsetting margins on the wholesale side) in order to stifle, impede and exclude competition from independent" providers of Internet-access service. *Id.* ¶ 25(A)(3) (JA36).

4. AT&T again moved to dismiss, arguing that the claim could proceed only if plaintiffs alleged facts supporting the two prerequisites for a predatory-pricing claim under *Brooke Group* – that is, pricing of the retail Internet-access service below cost and a likelihood of recoupment. The district court acknowledged that there was "persuasive appeal to Defendants' argument that the underlying logic of *Trinko*, which is that no inference of anticompetitive intent can be drawn from a refusal to deal where the parties are compelled by law to deal, applies with equal force to price squeeze claims." Pet. App. 55a. The court nevertheless denied the motion to dismiss. Though "inclined to apply the *Brooke Group* requirements to Plaintiffs' price squeeze claim," the court "conclude[d] that it need not and should not resolve this difficult

issue" because, "even if the *Brooke Group* requirements were applied, the [amended complaint] would satisfy those requirements." *Id.* at 47a-48a.[5]

The district court granted petitioners' motion to certify for interlocutory appeal its order denying petitioners' motion to dismiss. *See id.* at 56a-57a.[6] The Ninth Circuit granted interlocutory review. *See id.* at 92a.

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[5] In reaching this conclusion, the district court applied the now-overruled pleading standard of *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957), *overruled by Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1969 (2007). *See* Pet. App. 49a.

[6] As the government noted in its brief in support of the petition, there is some ambiguity about whether the district court intended to certify both the earlier (October 2004) order and its subsequent (April 2005) order on the amended complaint or whether it intended to certify only the October 2004 order. *See* U.S. Cert. Br. 18-19. The Ninth Circuit evidently believed that the amended complaint was before it. *See* Pet. App. 5a-8a (quoting allegations of the amended complaint). In either event, the district court's certification properly placed before the Ninth Circuit the question presented by AT&T's petition – whether plaintiffs' allegation that defendants engaged in a price squeeze stated a claim under the Sherman Act. The amended complaint includes more detailed factual allegations, but the substance of the price-squeeze allegation in the amended complaint is the same. Those more detailed allegations can supply one version of facts that plaintiffs may posit in defending their claim by illustrating what they think they could have proved under the initial complaint – and this Court may so consider the amended complaint for that purpose. *See Twombly*, 127 S. Ct. at 1969 (noting that, "once a claim for relief has been stated, a plaintiff receives the benefit of imagination, so long as the hypotheses are consistent with the complaint") (internal quotation marks omitted).

C. The Ninth Circuit's Opinion

A divided Ninth Circuit panel affirmed. The majority stated that, "[i]n antitrust terms, a price squeeze occurs 'when a vertically integrated company sets its prices or rates at the first (or "upstream") level so high that its customers cannot compete with it in the second-level (or "downstream") market.'" Pet. App. 8a (citation omitted). The court stated that, "[f]or over six decades, federal courts have recognized price squeeze allegations as stating valid claims under the Sherman Act." *Id.* at 8a-9a (citing, *inter alia*, *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 437-38 (2d Cir. 1945) ("*Alcoa*")). The court also noted its prior holding that "claims of price squeezing under § 2 are viable against monopolists in regulated industries." *Id.* at 9a (citing *City of Anaheim*).

The court acknowledged *Trinko*'s holding that "failure by a monopolist to deal with a competitor on certain service terms when that monopolist was under no duty to deal with the plaintiff . . . did not state a claim under § 2 of the Sherman Act." *Id.* at 9a-10a. It stated that *Trinko* thus "raised the question of whether a price squeeze is merely another term of the deal governed by the Supreme Court's analysis in *Trinko*, or whether it is something else." *Id.* at 10a. Stating that the circuits were already in conflict over the question, *see id.* (comparing *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044, 1050 (11th Cir. 2004) (allowing a "price squeezing" claim to proceed), *cert. denied*, 544 U.S. 904 (2005), with *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666, 673-74 (D.C. Cir. 2005) (rejecting price-squeeze claim in the absence of a duty to deal in the

upstream input)),[7] the court concluded that the case before it was controlled by the Ninth Circuit's earlier decision in *City of Anaheim*, which recognized potential price-squeeze claims.

The majority offered two reasons for its decision. *First*, it stated that "*Trinko* did not involve a price squeezing theory" and that, "[b]ecause a price squeeze theory formed part of the fabric of traditional antitrust law prior to *Trinko*, those claims should remain viable notwithstanding either the telecommunications statutes or *Trinko*." Pet. App. 14a. *Second*, the court determined that the standard established in *City of Anaheim* was appropriately circumscribed by the requirement that a plaintiff alleging a price squeeze in a regulated industry show "specific intent on the part of the wholesale monopoly holder to 'serve its monopolistic purposes at [retail competitors'] expense.'" *Id.* (quoting *City of Anaheim*, 955 F.2d at 1378) (alteration in original).

The court also stated that "the existence of regulation does not always eliminate the danger of anticompetitive harm." *Id.* at 15a. "The key, under *Trinko*, is the nature of the regulatory structure at issue." *Id.* The court found itself "confronted with a partially regulated industry": while, "[a]t the wholesale level, there are a series of regulatory mecha-

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[7] In fact, the Ninth Circuit's suggestion that there was an existing circuit split was mistaken. As AT&T had explained to the Ninth Circuit, what the Eleventh Circuit referred to as "price squeezing" was in substance a claim for predatory pricing under this Court's test in *Brooke Group*. *See Covad v. BellSouth*, 374 F.3d at 1049-52; *see also Covad Communications Co. v. Bell Atlantic Corp.*, 407 F.3d 1220, 1222 (D.C. Cir. 2005) (order on denial of rehearing) (noting that, in *Covad v. BellSouth*, "the complaint alleged the 'basic prerequisites for . . . price predation'") (quoting 374 F.3d at 1050) (alteration in original).

nisms and regulatory agencies charged with assuring fair play," *id.* at 16a, there is "no comparable regulatory attention paid to the retail DSL market," *id.* at 18a. "It is unclear at this juncture the extent to which linkLine is basing its § 2 price squeezing theory on wholesale pricing, retail pricing, or both. However, since linkLine could prove facts . . . that involve only unregulated behavior at the retail level," its claim could not be dismissed on the pleadings. *Id.*[8]

Judge Gould dissented. In his view, *Trinko* "takes the issues of wholesale pricing out of the case"; to state a claim under Section 2, therefore, plaintiffs would have to allege the elements of a predatory-pricing claim with respect to "retail sales of internet connection[s]." *Id.* at 20a-21a. Under this standard, the amended complaint failed to state a claim: "plaintiffs . . . did not allege that the seller had the market power to set prices for internet connection[s] in the retail market, that [petitioners'] retail price, contributing to the squeeze, was set below cost, and that losses could later be recouped." *Id.* at 23a.

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[8] The Ninth Circuit directed the district court to assess the viability of the claim at summary judgment based on "whether the complained of behavior took place at the regulated wholesale level, the unregulated retail level, or some combination of the two, and to what extent, if any, the responsible agencies have devoted attention to or had involvement in the complained of conduct." Pet. App. 18a.

SUMMARY OF ARGUMENT

Section 2 of the Sherman Act places no obligation on a wholesale monopolist to assist its retail rivals by providing them with a sufficient margin to operate profitably – particularly when the wholesale monopolist has no antitrust duty to deal in the first place.

I. That conclusion follows first from the plain holding of *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004). The plaintiff in that case complained that the defendant failed to provide wholesale network facilities and services to retail competitors in a manner that would allow them to compete effectively in the market for local telephone service. *See id.* at 404-05, 407. This Court held that such an alleged "refusal to cooperate with a rival" could not state a claim under the Court's existing Section 2 precedents where the defendant had no duty, under the antitrust law, to deal with its rival. *See id.* at 408-09. The Court found that no such duty existed where the defendant's dealing had been compelled by regulation and where the wholesale inputs had never been offered voluntarily to non-rivals. *See id.*

Respondents' price-squeeze allegations in this case are indistinguishable in substance from the allegations at issue in *Trinko* and fail for the same reasons. The complaint here alleges that AT&T "created a price squeeze" as one of a series of acts intended to deny respondents access to network facilities allegedly required to compete in the retail Internet-access market. *See* Compl. ¶ 23 (JA18-19). Such an allegation cannot state a claim under Section 2 in the absence of an antitrust duty to provide the facilities in the first place, a duty that does not exist here.

II. The Ninth Circuit majority reasoned that respondents' price-squeeze claim could proceed notwithstanding *Trinko* because such a claim "'satisf[ies] established antitrust standards.'" Pet. App. 14a (quoting *Trinko*, 540 U.S. at 406). But this Court has never recognized "price squeeze" as an independent antitrust tort. *Cf. Trinko*, 540 U.S. at 410-11 (noting that the Court has never recognized lower courts' "essential facilities" doctrine). To the contrary, the hallmark of a price squeeze – the reduction or elimination of the margin between a vertically integrated producer's wholesale and retail prices and resulting reduction in retail competitors' profits – speaks solely to the impact of conduct on *competitors*, not on *competition*, as a process for promoting economic efficiency. Such a doctrinal focus is at odds with the core principle that the Sherman Act was "enacted for the protection of *competition* not *competitors*." *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (internal quotation marks omitted).

A. That a price squeeze may eliminate rivals' margins does not mean that it harms *competition* in the relevant sense. *See Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 23 (1st Cir. 1990) (Breyer, J.). "Even when a monopolist at one essential stage 'monopolizes' a second stage, consumer harm cannot be inferred and is difficult to identify." 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 756b, at 11 (2d ed. 2002). For that reason, this Court has held that Section 2 does not condemn "monopoly leveraging" – even when the use of monopoly power allows the defendant to gain a dominant position in a second market – in the absence of conduct that is

otherwise subject to condemnation under Section 2. *Trinko*, 540 U.S. at 415 n.4.

B. A rule treating the existence of a price squeeze as sufficient to state a claim under Section 2 would risk deterring conduct that provides immediate benefit to consumers and enhances efficiency. First, by basing liability on the absence of a sufficient margin between wholesale and retail prices, the doctrine discourages retail price cuts that provide concrete benefits to consumers. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223-24 (1993). Second, the doctrine would deter efficient voluntary dealing – or vertical integration into downstream markets – by wholesale monopolists now threatened with the burden of protecting the welfare of downstream competitor-customers. Third, as with imposition of duties to deal, recognition of price-squeeze claims would reduce incentives for innovation and investment.

C. The inquiry that "price squeeze" claims require "burdens courts with the prohibitive administrative task of administering the monopolist's prices." 3A Areeda & Hovenkamp ¶ 767d2, at 132. Courts and juries would be required to supervise prices at not one but two levels, "a role for which they are ill suited." *Trinko*, 540 U.S. at 408. Moreover, the possibility that a price squeeze reflects competitive behavior and superior efficiency means that "false condemnations" of benign price squeezes would "'chill the very conduct the antitrust laws are designed to protect.'" *Id.* at 414 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)).

D. On top of all the foregoing reasons, allowing a price-squeeze theory of liability to proceed is particularly inappropriate in circumstances where

the wholesale monopolist has no duty to deal under the antitrust laws. In such circumstances, from the point of view of antitrust law, the wholesale monopolist is free to refuse to deal at all – even if downstream rivals are unable to compete without such assistance – and there is no incremental harm to consumers from arriving at the same result gradually through a price squeeze.

III. Stretching the antitrust laws to encompass a potential price-squeeze claim is particularly unwarranted because "a regulatory structure" already exists "to deter and remedy anticompetitive harm." *Trinko*, 540 U.S. at 412. The FCC has, for nearly four decades, actively policed the provision of information services by communications companies, modifying the scope of regulatory duties-to-deal with unaffiliated information-service providers in response to changing market conditions. *See National Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 1001 (2005). The FCC has authority to address price-squeeze allegations that are said to violate regulatory obligations. *Cf. FPC v. Conway Corp.*, 426 U.S. 271 (1976). In light of this regulatory oversight, "the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny." *Trinko*, 540 U.S. at 412.

ARGUMENT

I. *TRINKO* GOVERNS RESPONDENTS' PRICE-SQUEEZE CLAIM AND MANDATES DISMISSAL

Respondents' price-squeeze claim fails first of all because it is barred by *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004). There, this Court held that allegations that a monopoly supplier provided wholesale inputs in a manner that impeded wholesale customers' efforts to compete in downstream retail markets failed to state a claim under Section 2, at least in the absence of an affirmative duty to deal under the antitrust laws. That holding applies to respondents' claim that the price of DSL Transport was too high relative to the price that AT&T charged for DSL-based Internet-access service to allow respondents' to compete successfully.

The factual allegations of respondents' complaint and the complaint in *Trinko* are indistinguishable. In both cases, the gravamen of the complaint was that the defendant had manipulated its role as both a wholesale supplier and a retail competitor to place its wholesale customers at a relative disadvantage in the provision of retail service.

In *Trinko*, the plaintiff alleged that the defendant had "use[d] its control over the physical wires over which phone services are delivered . . . to hinder efforts by [new entrants] to enter into the business of providing local telephone service, while providing adequate services to customers using [the defendant] for their local phone service." Compl. ¶ 1 (*Trinko*

JA12).[9] Claiming that "[a]ccess to [the defendant's] wires is essential for the provision of local telephone service," the plaintiff alleged that the defendant "has deterred and will continue to deter potential customers from switching to another company for local telephone service or cause customers that had switched [to another company for local telephone service] to switch back." *Id.* ¶ 2 (*Trinko* JA13). The plaintiff thus alleged that the defendant had "used its monopoly power in the local loop market to gain a competitive advantage in the market for the provision of Local Phone Service," in particular by failing to provide access to the local loop "on a par with its own access." *Id.* ¶¶ 30, 63 (*Trinko* JA18, 29).

Similarly, respondents here alleged that AT&T had a monopoly in the supposed market for DSL Transport (the wholesale input) by virtue of its "control . . . of essential 'bottleneck' local telephone network facilities." Compl. ¶ 12 (JA14); Am. Compl. ¶ 12 (JA29). Respondents further alleged that ISPs "that are not affiliated with the incumbent local phone company . . . must obtain access to those customers['] connections in order to reach and serve their own end user customers." Compl. ¶ 18 (JA16); Am. Compl. ¶ 18 (JA31). "Because DSL transmission over the local loop is a bottleneck, defendants have undue influence over [plaintiffs'] commercial viability" in the provision of retail DSL-based Internet-access service. Compl. ¶ 18 (JA16); *see* Am. Compl. ¶ 19 (JA32). Thus, the alleged "price squeeze" places respondents "at a serious unfair disadvantage vis-a-vis" AT&T. Compl. ¶ 19 (JA17); *see* Am. Compl. ¶ 20 (alleging

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[9] References to "*Trinko* JA__" are to the Joint Appendix filed in *Trinko*, No. 02-682 (U.S. filed May 23, 2003), and in which the cited complaint in *Trinko* is reproduced.

that respondents are "unable to compete with [AT&T] in the retail market for DSL service") (JA33).

In *Trinko*, the Court recognized that, because the retail competitor's ability to compete with the defendant depended on the defendant's affirmative assistance – provision of the necessary wholesale input – such allegations amounted to a claim that the defendant had "refus[ed] to cooperate with rivals." *Trinko*, 540 U.S. at 408. The Court thus asked whether the allegations fell within the narrow "existing exceptions" to the basic rule that firms have no such duty under Section 2. *Id.* The Court concluded that the "alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court's existing refusal-to-deal precedents." *Id.* at 410.

The district court here reached the same conclusion – that AT&T had no duty to deal with respondents – and that proposition was "not disputed on appeal," Pet. App. 5a n.6. Indeed, because AT&T was "obligated by law to offer their DSL transport facilities to [respondents]," *id.*, there was no basis for any argument that AT&T "voluntarily engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion," *Trinko*, 540 U.S. at 409.[10] Likewise, there was no allegation that AT&T ever refused to provide to respondents any product

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[10] Respondents argued in the district court that, because the obligation to provide DSL Transport would not apply "if [AT&T] had not voluntarily entered the DSL market," AT&T's "dealings with [respondents] are ultimately the result of [AT&T's] *choice* to enter the DSL market." Pet. App. 84a. As the district court correctly held, however, "a law that says that one must do B if one does A is compulsory even if it leaves open the option of not doing A." *Id.* at 85a.

"that it already sold at retail" to other customers. *Id.* at 410.[11]

Trinko thus establishes that, at least where AT&T has no duty to deal with respondents, it likewise has no duty to deal with them in a manner that would promote their success in the alleged downstream market for DSL-based Internet-access service. That conclusion applies just as plainly to the allegation that AT&T charged too much for DSL Transport as it does to a claim that other terms of AT&T's provision of that wholesale input were inadequate. "Any claim for excessive rates can be couched as a claim for inadequate services and vice versa." *AT&T Co. v. Central Office Tel., Inc.*, 524 U.S. 214, 223 (1998). There is no substantive difference between an allegation that, as a result of the *poor quality* of the wholesale input, a plaintiff's retail product was unattractive to consumers relative to the defendant's retail product at the price the plaintiff could profitably charge and an allegation that, as a result of the *high price* of the wholesale input, a plaintiff's retail product was unattractive to consumers relative to the defendant's retail product at the price the plaintiff could profitably charge. In both cases, the allegation is that the defendant has taken advantage of its control over the wholesale input to make its customer-

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[11] In opposing certiorari, respondents argued that the alleged price squeeze "is akin to . . . the refusals to sell to competitors at retail prices for services 'otherwise marketed or available to the public.'" Cert. Opp. 26. But, as respondents acknowledged, what AT&T sells to retail customers is something different – DSL-based Internet-access service – not the DSL transmission capacity it sells to respondents. *See id.* at 8; *see also* Compl. ¶¶ 11 (alleging "relevant market[] . . . for Digital Subscriber Lines"), 12 (alleging "[a]nother relevant market . . . for Internet services") (JA13); *supra* p. 3; U.S. Cert. Br. 9 n.4.

competitor's downstream product unattractive in comparison to its own. *See* U.S. Cert. Br. 9 ("[R]espondents' price-squeeze allegations amount to nothing more than a claim that petitioners refused to deal on terms that respondents desired.").

The Ninth Circuit's conclusion that *Trinko* did not apply to respondents' price-squeeze claim, *see* Pet. App. 14a, is incorrect.

II. RECOGNITION OF PRICE SQUEEZE AS AN INDEPENDENT ANTITRUST TORT CONFLICTS WITH THIS COURT'S PRECEDENT

The Ninth Circuit went on to hold that respondents' price-squeeze claim could proceed because "price squeeze theory formed part of the fabric of traditional antitrust law prior to *Trinko*." Pet. App. 14a; *see also id.* at 8a ("For over six decades, federal courts have recognized price squeeze allegations as stating valid claims under the Sherman Act."); Statement of the Federal Trade Commission at 3-4, Re: Petition for a Writ of Certiorari in *Pacific Tel. Co. [sic] d/b/a AT&T California v. linkLine Commns., Inc.* (No. 07-512) (May 2008) ("Price-squeeze claims have long been part of the Section 2 doctrine.") ("FTC Statement") (citation omitted). But this Court has never recognized a price-squeeze theory of antitrust liability. *See* U.S. Cert. Br. 11 ("[T]he price-squeeze theory of antitrust liability has never been recognized by this Court."); *cf. Trinko*, 540 U.S. at 410-11. To the contrary, "[w]hen the defendant has no antitrust duty to deal, price-squeeze allegations that are based solely on the margin between an integrated defendant's wholesale and retail prices cannot be reconciled with this Court's . . . antitrust jurisprudence." U.S. Cert. Br. 11.

This is true for several reasons. First, the basis for price-squeeze liability – that is, the elimination of a margin sufficient to sustain downstream competitors – raises no inference of harm to competition. Second, recognition of price-squeeze claims would deter conduct that benefits consumers. Third, because price-squeeze doctrine would saddle courts with prohibitive administrative burdens, any potential competitive impact from a price squeeze "'should be deemed irremedia[ble] by antitrust law.'" *Trinko*, 540 U.S. at 415 (quoting Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L.J. 841, 853 (1989)) (alteration in original). Finally, all of these conclusions apply with special force where a defendant has no duty to deal.

A. The Existence of a Price Squeeze – Even One That Causes Competitors To Exit the Downstream Market – Does Not Support Any Inference of Harm to Competition

Under the standard articulated by the Ninth Circuit, the touchstone for price-squeeze liability is that a vertically integrated monopolist has set its upstream wholesale price "so high that its customers cannot compete with it" in the downstream retail market. Pet. App. 8a (internal quotation marks omitted). That broad articulation of the price-squeeze standard follows from the Second Circuit's decision in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) ("*Alcoa*"). There, the Second Circuit imposed liability under Section 2 where a wholesale-level monopolist set its wholesale prices above a "fair price" and its retail prices too

low to allow its downstream competitors to make "a living profit." *Id.* at 437.[12]

Thus articulated, price-squeeze doctrine focuses on the well-being of downstream competitors and is therefore inconsistent with the principle that the antitrust laws "were enacted for the protection of *competition* not *competitors*." *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (internal quotation marks omitted). As Judge Posner has explained, this principle means that antitrust law does not seek to preserve "competition as a process of rivalry" for its own sake but "competition as a means of promoting economic efficiency." *Olympia Equip. Leasing Co. v. Western Union Tel. Co.*, 797 F.2d 370, 375 (7th Cir. 1986). "Any rule of price-squeeze liability that threatens liability based on the claim that the difference between a firm's upstream and downstream prices leaves downstream rivals an insufficient profit margin substitutes a rule of competitor welfare for consumer welfare." J. Gregory Sidak, *Abolishing the Price Squeeze as a Theory of Antitrust Liability*, 4 J. Competition L. & Econ. 279, 294 (2008).

The fact that "a 'one-level' monopolist engaged in a prolonged price squeeze may drive independent competitors out of business and thereby extend its

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[12] The Second Circuit indicated that the mere existence of a price squeeze could constitute "an unlawful exercise of 'Alcoa's' power" in the market for aluminum ingot, even if "it was not part of an attempt to monopolize the 'sheet' market." 148 F.2d at 438. The suggestion that "*exercise*" of monopoly power by charging high prices violates Section 2 is, however, contrary to this Court's understanding that "[t]he mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system." *Trinko*, 540 U.S. at 407.

monopoly power to a second industry level . . . does not mean that a price squeeze is anticompetitive." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 23 (1st Cir. 1990); *see* 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 756b, at 11 (2d ed. 2002). In a case – like this one – where the wholesale input and the downstream product are in fixed proportion, an upstream monopolist generally cannot earn any greater profits by eliminating an efficient competitor in the downstream market. "The reason is that [the upstream monopolist] Firm 1 already has all the power it needs, by assumption, to extract the profit from [the downstream retail competitor] Firm 2 by raising [the price of the wholesale input] to just enable Firm 2 to earn a normal rate [of] return without driving Firm 2 out of business. Firm 1 gains nothing further by destroying Firm 2." Dennis W. Carlton, *Should "Price Squeeze" Be a Recognized Form of Anticompetitive Conduct?*, 4 J. Competition L. & Econ. 271, 275 (2008); *Western Res., Inc. v. Surface Transp. Bd.*, 109 F.3d 782, 787 (D.C. Cir. 1997) ("there is only one monopoly profit to be gained from the sale of an end-product or service"); *Town of Concord*, 915 F.2d at 23.[13]

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[13] It has been argued that a benefit of preserving downstream rivals is that it may facilitate those rivals' eventual challenge to the defendant's wholesale monopoly. *See Town of Concord*, 915 F.2d at 24; FTC Statement at 4-5. In this case, of course, there was no allegation that respondents had any intention of challenging AT&T's alleged wholesale monopoly – to the contrary, respondents alleged that the "local telephone network facilities . . . through which local telecommunication services are provided . . . cannot practically or reasonably be duplicated." Compl. ¶ 12 (JA14). In any event, it is inconsistent with recognized limits on the reach of Section 2 to require a monopolist to assist a potential rival by protecting its downstream profits for the (highly speculative) purpose of promoting upstream entry.

Recognizing that "extension" of a monopoly is not in itself anticompetitive, this Court has held that Section 2 does not condemn "monopoly leveraging" – use of monopoly power to gain an advantage in a second market – unless it involves otherwise wrongful conduct. *Trinko*, 540 U.S. at 415 n.4.[14]

Further, any possible anticompetitive consequences stemming from the inability of a second-level rival to remain in the market must be balanced against the likelihood that the retail competitors' inability to compete is the result of desirable efficiencies, from which consumers benefit. As the leading treatise recognizes, the traditional suspicion of "price squeeze" reflects a misplaced concern about vertical integration. *See* 3A Areeda & Hovenkamp ¶ 767c, at 126 ("it is difficult to see any *competitive* significance [of a price squeeze] apart from the consequences of vertical integration itself"). But vertical integration "can produce significant cost reductions" by enabling the integrating firm to achieve both "'[p]roduction' efficiencies" – that is, "savings in the cost of producing or distributing goods" – and "'[t]ransactional' efficiencies" – that is, avoidance of costs associated with dealing with other firms. *Id.* ¶ 757a, at 23. Where this is so, "prices that squeeze the less efficient second-level competitors, even to the point of forcing

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See Trinko, 540 U.S. at 415-16 (noting that duties intended to promote competitive entry are "much more ambitious than the antitrust laws").

[14] In any event, as the dissent below pointed out, the alleged possibility that AT&T might achieve a monopoly in high-speed Internet-access service ignores the reality that AT&T must compete with alternative platforms, including "cable and . . . satellite" as well as wireless networks. Pet. App. 19a-20a; *see supra* note 4.

them from the business, could (by lowering costs) lower prices, or, in any event, save economic resources." *Town of Concord*, 915 F.2d at 24. Moreover, when second-level rivals "exhibit[] some market power," a price squeeze may reflect elimination of supra-competitive margins at the second level. 3A Areeda & Hovenkamp ¶ 756b3, at 14-15. In this situation as well, "price will ordinarily come down and output will ordinarily increase." *Id.*; *see Town of Concord*, 915 F.2d at 24-25.

In sum, the existence of a price squeeze – even if it leads to downstream rivals' exit from the market – provides no sound basis for inferring consumer harm, the concern of antitrust law.

B. Recognition of Price-Squeeze Claims Would Deter Pro-Competitive Conduct

Treating the existence of a price squeeze as the basis for a claim under the antitrust laws is unwarranted for the additional reason that such a rule would discourage pro-competitive conduct.[15] *See generally* David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. Chi. L. Rev. 73, 81 (2005) ("Barring procompetitive practices is likely to

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[15] Almost by definition, price-squeeze claims are brought by rivals, not by consumers; consumers benefit from the very downstream prices that discomfit rivals. This provides an additional reason to be skeptical about such claims. *See* William J. Baumol & Alan S. Blinder, *Economics: Principles & Policy* 275 (10th ed. 2006) (noting that "[o]ne problem that haunts most antitrust litigation is that vigorous competition may look very similar to acts that *undermine* competition and support monopoly power" and that "effective competition by a firm is always tough on its rivals").

be more costly, on average, than permitting anti-competitive practices.").

First, and most obvious, recognition of price-squeeze claims exerts pressure on a vertically integrated monopolist to keep its downstream retail prices high. *See* Carlton, *Price Squeeze* at 277 (noting that, "[i]f there were a recognized price squeeze theory and the courts subjected firms to it, then [a vertically integrated monopolist] might charge a higher price than necessary for [the downstream product] to avoid any possible litigation"; such higher prices would "lead to consumer harm"); *see also* Sidak, *Abolishing Price Squeeze* at 297 ("[T]he price-squeeze theory of liability . . . permits the misuse of an antitrust doctrine as [a] vehicle for keeping retail prices high.").[16] Even if superior efficiency were a justification for a price squeeze, it would always be difficult for an adjudicator to distinguish a price squeeze resulting from such efficiency from a price squeeze resulting from supposedly excessive wholesale prices. *See Town of Concord*,

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[16] A doctrine that requires a wholesale monopolist to preserve downstream rivals' margins may bring about higher prices in another way – that is, by inducing rivals to coordinate retail prices. Armed with a potential claim under Section 2, a downstream rival is likely to "ask or demand that the monopolist eliminate the squeeze," and the "vertically integrated monopolist faces an incentive to behave like a price fixer" by raising its retail prices in response to the demand. Sidak, *Abolishing Price Squeeze* at 297; Herbert J. Hovenkamp & Erik N. Hovenkamp, *The Viability Of Antitrust Price Squeeze Claims*, Univ. of Iowa Legal Studies Research Paper No. 08-33, at 28 (July 2008) ("[R]ecognition of [price-squeeze] claims, if based on a rule that entitles the smaller firm to a profitable margin, would virtually require price fixing by the two firms."). In this way, recognition of price-squeeze liability "may facilitate the supreme evil of antitrust: collusion." *Trinko*, 540 U.S. at 408.

915 F.2d at 24; Carlton, *Price Squeeze* at 276 ("[T]he inquiry as to whether a price squeeze leads to competitive harm necessarily must be conducted ex post, which therefore makes it impossible for a firm to know in advance whether its pricing practices will be anticompetitive."). The existence of a rule subjecting price squeezes to special antitrust scrutiny could thus discourage aggressive retail pricing, harming consumers. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) ("discouraging a price cut and . . . depriving consumers of the benefits of lower prices . . . does not constitute sound antitrust policy"); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) ("Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.").[17]

Second, subjecting a wholesale monopolist to potential liability for a price squeeze would deter efficient vertical integration and socially desirable, voluntary dealing. A monopolist might offer an upstream product, used by another firm to produce a downstream product. If the monopolist begins to produce the downstream product itself, it might well

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[17] Respondents did not allege, either in the complaint or in the amended complaint, that AT&T engaged in predatory pricing. Neither complaint alleges either pricing below cost or a likelihood of recoupment. A price squeeze – even one involving a wholesale price that exceeds the defendant's retail price – need not involve any below-*cost* pricing. *See* Hovenkamp & Hovenkamp, *Viability Of Price Squeeze* at 20. Thus, there is no "sacrifice[e]" of profits at the retail level, and, in any event, it is nonsensical to allege that AT&T could make up for such a "sacrifice[e]" through increased "margins" on the wholesale side, Am. Compl. ¶ 25(A)(3) (JA36), when the complaint alleges that AT&T is trying to force its wholesale customers out of business.

face the prospect of price-squeeze litigation brought by the current downstream producer. Such a possibility might either deter the monopolist from entering the downstream market (even in cases where it would be more efficient than existing rivals) or deter the monopolist from selling to downstream producers in the first place. *See* Carlton, *Price Squeeze* at 277-78; *cf. Olympia*, 797 F.2d at 375 (if a firm "lay[s] itself open to an antitrust suit" when it deals voluntarily with rivals, it will likely refrain from such dealing). In either case, consumers are harmed.

In fact, the very incidents of vertical integration that yield the greatest consumer benefit – lower-cost production in downstream markets – are precisely those that will "squeeze" downstream competitors. As this Court has remarked with respect to claims of above-cost predatory pricing claims, in many cases "the exclusionary effect [here, of price squeeze] . . . reflects the lower cost structure of the alleged predator, and so represents competition on the merits." *Brooke Group*, 509 U.S. at 223. Hence, a rule that outlaws price squeezes penalizes those instances of vertical integration – and behavior by vertically integrated monopolists – that promise the greatest benefit.

Third, by threatening antitrust liability based in part on allegedly high wholesale prices charged by a lawful monopolist, price-squeeze claims impinge on "an important element of the free-market system," that is, a legitimate monopolist's "opportunity to charge monopoly prices." *Trinko*, 540 U.S. at 407. Allowing such claims to proceed would thus undermine incentives for "innovation and economic growth." *Id.*[18]

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[18] *See* 3A Areeda & Hovenkamp ¶ 767d2, at 133 ("[A] common consequence of [*Alcoa*'s] 'solution' is to confront a monopo-

More generally, forcing a firm to protect its downstream rivals from the possibility of a price squeeze is one way of "[c]ompelling such firms to share the source of their advantage," which may "lessen the incentive for the monopolist, the rival, or both to invest in . . . economically beneficial facilities." *Id.* at 407-08; *see also AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 429 (1999) (Breyer, J., concurring in part and dissenting in part) ("It is in the *un* shared, not in the shared, portions of the enterprise that meaningful competition would likely emerge."); Hovenkamp & Hovenkamp, *Viability Of Price Squeeze* at 5-6 (forcing a wholesale monopolist to maintain a downstream rival's profitability "has the perverse effect of removing that rival's incentive to innovate, as it receives the same returns regardless of any improvements").

C. Price-Squeeze Doctrine Imposes Inappropriate Regulatory Burdens on Antitrust Courts

Recognition of a duty under the antitrust laws to avoid "anticompetitive" price squeezes would also impose inappropriate administrative burdens on antitrust courts, contrary to this Court's antitrust teaching. *Trinko* holds that antitrust laws eschew imposition of duties that would "require[] antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are ill suited" – or that would

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list with two choices: to forgo monopoly profits or to avoid or abandon partial vertical integration. It is thus inconsistent with either of two other basic legal propositions: that a lawful monopolist is entitled to charge a monopoly price, and that partial vertical integration by a monopolist is presumptively lawful because it is economically beneficial.").

"require continuing supervision of a highly detailed decree." 540 U.S. at 408, 414-15. Yet recognition of price-squeeze claims would require courts to supervise prices at not one but *two* levels – the prices for both wholesale inputs and downstream retail services – and ensure that their interaction did not unduly restrict competitors' ability to compete in the retail market. *See* 3A Areeda & Hovenkamp ¶ 767d2, at 132 (price-squeeze doctrine, as articulated in *Alcoa*, "burdens courts with the prohibitive administrative task of administering the monopolist's prices").

Indeed, the *Alcoa* price-squeeze test invoked by the Ninth Circuit – which makes liability turn on a monopolist's "charg[ing] more than a 'fair price' for the primary product while simultaneously charging so little for the secondary product that its second-level competitors cannot make a 'living profit'" – is famously difficult to administer. *Town of Concord*, 915 F.2d at 25.

> [H]ow is a judge or jury to determine a "fair price?" Is it the price charged by other suppliers of the primary product? None exist. Is it the price that competition "would have set" were the primary level not monopolized? How can the court determine this price without examining costs and demands, indeed without acting like a rate-setting regulatory agency, the rate-setting proceedings of which often last for several years? Further, how is the court to decide the proper size of the price "gap?" . . . And how should the court respond when costs or demands change over time, as they inevitably will?

Id.[19]

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[19] *But see* FTC Statement at 4 (arguing that "a profit sufficient for participants in the second market to compete" is "at

Nor is it an answer to this conundrum to require that the monopolist maintain a margin between wholesale and retail prices that reflects its own incremental costs of production.[20] There is no basis in antitrust law for requiring a vertically integrated producer to treat the *price* charged to others for a wholesale input as the *cost* of the input to itself; to the contrary, such a requirement ignores economic reality and would again deprive the producer and consumers of the benefits of vertical integration. *See* 3A Areeda & Hovenkamp ¶ 757a, at 24 ("It is not antitrust's purpose to condemn cost-reducing innovations or structures, even if one consequence is to injure rivals unable to match the cost reductions."). As a lawful monopolist in the wholesale product, an integrated producer is entitled to charge its customers the monopoly price for the wholesale input, but it is equally entitled to ignore the price charged to others and instead to consider the *cost* of producing that input in setting its own retail price. A contrary rule will exacerbate all the substantive ills discussed above, by placing upward pressure on retail prices and discouraging voluntary dealing.[21]

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least as clear as the undefined 'below-cost' standard in *Brooke Group*").

[20] This appears to be the standard that respondents intended to invoke in their amended complaint by alleging that, if AT&T "charged [its] retail affiliates the same wholesale costs for DSL transport that [it] charged [its] wholesale . . . customers . . . , defendants could not cover their wholesale costs and make a profit." Am. Compl. ¶ 25(A)(2)-(3) (JA35-36).

[21] The same observations apply to respondents' allegation that, for some period, AT&T's wholesale prices exceeded its retail prices. *See* Am. Compl. ¶ 20 (JA33).

Furthermore, in the complicated communications marketplace, a comparison of the wholesale prices to any set of "costs"

As one commentator has concluded, "[p]roperly understood, a price squeeze is a regulatory issue, which makes sense only as a rule of price regulation in an industry already subject to duties to deal and to control by institutionally competent regulators." Sidak, *Abolishing Price Squeeze* at 294. "[A]ssessing [price-squeeze] claims requires a court to predict the 'correct' price, and doing so places it in the position of a public utility regulator. That objection was good when Judge Breyer uttered it in 1990 . . . , and it remains so today." Hovenkamp & Hovenkamp, *Viability Of Price Squeeze* at 28. As with claims of above-cost price-predation, therefore, a claim of anticompetitive price squeeze should be treated as "'beyond the practical ability of a judicial tribunal to control.'" *Trinko*, 540 U.S. at 414 (quoting *Brooke Group*, 509 U.S. at 223).

D. Recognition of Price-Squeeze Claims Is Particularly Inappropriate in the Absence of Any Antitrust Duty To Deal

Based on the foregoing considerations, leading economists – including the immediate past chief economist in the Department of Justice Antitrust Division – and legal commentators have concluded that judicial recognition of price squeeze as a theory

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is likely to be both difficult and contentious. By providing Internet-access service, AT&T may acquire sources of revenue that supplement the retail service fee – advertising, sale of additional services, partnerships with other businesses. Thus, a simple comparison between the price of DSL Transport and the basic retail price of Internet-access service says nothing about whether wholesale cost exceeds expected per-subscriber revenue – as the familiar examples of free Internet-access service and free e-mail service illustrate. Moreover, a comparison of static costs and revenues ignores altogether long-term strategic considerations.

of antitrust liability is unwise. *See* Carlton, *Price Squeeze* at 278 ("Using a general theory of price squeeze to create antitrust liability is likely to chill competition and harm consumers."); Sidak, *Abolishing Price Squeeze* at 294 ("It is not possible to advance consumer welfare with an antitrust rule that punishes a firm for failing to ensure its competitors' profitability.").

The question presented here, however, is narrower, because AT&T had no antitrust duty to deal with respondents at all. As a result, the potential antitrust benefit from imposition of a duty to avoid a price squeeze is non-existent. From the point of view of antitrust law, AT&T could have stopped dealing with respondents altogether without incurring any liability. There is no basis for imposing an antitrust duty on a firm to shelter its competitors by avoiding a price squeeze when the firm has no obligation to deal at all. *See* Hovenkamp & Hovenkamp, *Viability Of Price Squeeze* at 14 ("[a]ssuming that the refusal to deal and 'instant' termination of the smaller firm were legal to begin with, . . . it is difficult to see how" an alleged price squeeze could cause any "incremental consumer harm").

At the same time, all of the undesirable substantive and institutional consequences of recognizing a price-squeeze theory of liability are nonetheless present and some are accentuated. A defendant will face the same disincentive to price aggressively at the retail level; will face a strong disincentive to commence voluntary dealing and diminished incentives to enter downstream markets; and will continue to face a penalty for charging otherwise lawful prices. And courts will continue to confront an intractable problem of direct price administration.

This is why the D.C. Circuit and the "leading treatise" have recognized that "'it makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal.'" *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666, 673-74 (D.C. Cir. 2005) (quoting 3A Areeda & Hovenkamp ¶ 767c5, at 129-30). This Court should endorse that view and reverse the Ninth Circuit's decision.

III. THE EXISTENCE OF REGULATORY OVERSIGHT PROVIDES AN ADDITIONAL REASON TO DISMISS THE COMPLAINT

The regulatory context in which respondents' claim arises provides an additional reason not to stretch Section 2 to reach the alleged conduct.

"'[A]ntitrust analysis must sensitively recognize and reflect the distinctive economic and legal setting of the regulated industry to which it applies.'" *Trinko*, 540 U.S. at 411 (quoting *Town of Concord*, 915 F.2d at 22). The FCC has been actively involved for nearly four decades in the regulation of computer-related services provided over communications networks. *See* Pet. App. 78a-84a (describing history of FCC regulation of provision of "enhanced services" by telecommunications companies); *see also National Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 975-77 (2005). The FCC first adopted various regulations designed to afford unaffiliated providers of computer-related services access to local telephone companies' networks on terms that would seek to eliminate telephone companies' natural advantages over unaffiliated providers. Over time, the FCC has eased those regulations in various respects, and in recent years – in light of increased competition among facilities-based providers of Internet-access

service – it has eliminated many pre-existing restrictions. Throughout that period, the expert regulator has had the opportunity to calibrate regulatory obligations in response to changing market conditions. *See Brand X*, 545 U.S. at 1001.

With respect to the pricing issues implicated in this case, the FCC has the authority to enforce statutory requirements that the rates AT&T charges for interstate telecommunications services – including the rate for DSL Transport – be "just and reasonable," 47 U.S.C. § 201(b), and not unreasonably discriminatory, *id.* § 202(a). The Ninth Circuit observed that AT&T's retail Internet-access prices are not subject to direct regulatory control, *see* Pet. App. 18a, but the FCC's deliberate choice not to regulate downstream retail prices does not mean that respondents had no opportunity to bring the alleged price squeeze at issue here to regulators' attention. To the contrary, it has always been open to respondents to argue that AT&T's wholesale prices are unlawful in light of AT&T's retail prices. *Cf. FPC v. Conway Corp.*, 426 U.S. 271, 277-79 (1976) (holding that Federal Power Commission had authority to consider relationship of jurisdictional and non-jurisdictional rates in determining whether jurisdictional rates were just, reasonable, and nondiscriminatory).

The FCC's existing regulations therefore provided a "regulatory structure" designed "to deter and remedy" any "anticompetitive harm" that might arise from the sort of price squeeze alleged here. *Trinko*, 540 U.S. at 412. "Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny." *Id.*

Following on the panel majority's observation regarding the absence of direct regulation of retail prices, respondents have argued that a price-squeeze claim should be permitted here because AT&T is regulated "'at only one level'" and may be "'seek[ing] to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first.'" Cert. Opp. 32 (quoting *Town of Concord*, 915 F.2d at 29). But this argument fails for at least three reasons. First, respondents have not alleged facts that would support any such theory in this case; to the contrary, respondents alleged that AT&T intends to make up for a reduction in margins *at the unregulated retail level* by charging more at the *regulated* wholesale level. *See* Am. Compl. ¶ 25(A)(3) (JA36). Second, as explained above, because the FCC has authority to take retail rates into account in assessing rates charged at the wholesale level, the FCC could address any such supposed "regulatory avoidance" directly. Third, and most fundamentally, the task of enforcing regulatory obligations is one for regulators, not for antitrust courts. *See Trinko*, 540 U.S. at 406-07, 415-16; *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 136-37 (1998). Thus, while respondents argue that "the existence of sharing duties" under FCC regulations "supports [their] case," this Court should reject that argument here as it did in *Trinko*. 540 U.S. at 411.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded with instructions to dismiss the complaint.

Respectfully submitted,

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